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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the petition of Pacific Bell (U 1001 C) for arbitration of an interconnection agreement with Pac-West Telecomm, Inc. (U 5266 C) pursuant to Section 256(b) of the Telecommunications Act of 1996.	Application 98-11-024 (Filed November 16, 1998)

FINAL ARBITRATOR'S REPORT

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1. SUMMARY

The arbitrated result adopts definitions of local calls and toll free service that are consistent with current rating and routing practice. The Interconnection Agreement term will be two years. Prices are those recommended by Pacific Bell. Compensation will be for calls, not call attempts. The Agreement will include a true-up provision for a successor agreement. Intellectual property and interconnection indemnity will not be bilateral. The Agreement shall be subject to modification consistent with subsequent actions of government agencies.

Parties shall file an Interconnection Agreement that conforms to the arbitrated decisions herein within seven days of the filing of the Final Arbitrator's Report, along with a statement of whether the Agreement should be adopted or rejected by the Commission.

2. BACKGROUND

On November 16, 1998, Pacific (Pacific or applicant) filed an application for arbitration pursuant to Section 252 of the Telecommunications Act of 1995 (Act).[1] By letter dated December 2, 1998, applicant and Pac-West Telecomm, Inc. (Pac-West or respondent) jointly stated their agreement that Pac-West's response could be delayed pending Commission consideration of a subsequent motion to

[1] The caption submitted by applicant contains a typographical error. Arbitration is sought by applicant pursuant to Section 252(b), not Section 256(b), of the Act.

dismiss.[2] They also agreed that the time period for a Commission decision under the Act would be extended from nine to ten months.[3]

On December 3, 1998, respondent filed a motion for immediate dismissal. By ruling dated December 7, 1998, the time for responses to Pac-West's motion was shortened to December 11, 1998. On December 11, 1998, applicant filed a response in opposition to the motion. Also on December 11, 1998, respondent filed a reply to applicant's response.

An Initial Arbitration Meeting was held on December 21, 1998. By letter dated December 23, 1998, applicant and respondent jointly agreed to an additional delay in the filing of Pac-West's response, and a further extension of time from 10 to 11 months for a Commission decision under the Act.

On February 4, 1999, the Commission denied respondent's motion for dismissal. (Decision (D.) 99-02-014.) Consistent with the agreed upon schedule, Pac-West filed its response on February 8, 1999. On February 17, 1999, the parties jointly filed a revised statement of unresolved issues (also referred to as the issues matrix), and applicant served testimony in response to the issues raised by respondent. A total of 41 items were presented for arbitration within 22 specifically identified issues.

Arbitration conferences and hearings were held on February 22, 23, 24, 25, and March 4, 1999. On March 8, 1998, parties served a further revised statement

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[2] All references to the Commission are to the California Public Utilities Commission. References to the Federal Communications Commission are noted separately.

[3] The Act requires that arbitrations be completed by State Commissions within nine months after the date on which the local exchange carrier receives a request for negotiation under the Act. (47 U.S.C. Section 252(b)(4)(C).)

of unresolved issues reflecting resolution of several issues. Briefs were filed on March 15, 1999, and the matter was submitted for preparation of the Draft Arbitrator's Report (DAR). As a result of resolution of many issues by the parties over the course of the hearings, 15 items were finally presented for arbitration within 11 issues.

At the request of the Arbitrator, on March 16, 1999 applicant served a revised complete Agreement reflecting what it understood to be joint acceptance of all items therein except for the specific items for which dueling clauses were presented in the statement of unresolved issues. By letter dated March 16, 1999, respondent pointed out that applicant's March 16, 1999 agreement did not contain "dueling clauses." On March 17, 1999, parties individually served a further revised statement of unresolved issues summarizing their support for each position.

By letter dated March 19, 1999, Pac-West stated that the Interconnection Agreement provided by Pacific on March 16, 1999 contained many differences from the Agreement as Pac-West understood it at that time. Pac-West asked that all of Pacific's changes be immediately rejected, that Pacific be ordered to refile the Agreement in the form it was previously communicated to Pac-West, and that Pacific be ordered to pay the expenses incurred by Pac-West in reviewing and responding to the changed Agreement. Alternatively, Pac-West said that if there is merit in studying any of Pacific's proposed changes, the Commission should dismiss Pacific's petition in its entirety and allow Pacific to refile when Pacific has finalized the Agreement it wishes to arbitrate.

By letter dated March 19, 1999, Pacific responded that it intended to submit a document that reflected no disagreements except those in the disputed issues matrix. Pacific said that it had no intention of adding issues not already presented in the arbitration.

By letter dated March 23, 1999, Pacific addressed the issues raised in Pac-West's March 19, 1999 letter, and provided another revised Agreement. Pacific asserted the revised agreement was consistent with the November 1998 version attached to the application with limited exceptions. In part, the exceptions removed price exhibits Pacific believed to be unnecessary. The revised agreement reflected Pacific's version of the issues set forth in the issues matrix.

By letter dated March 24, 1999, Pac-West stated its disagreement with elements of Pacific's March 23, 1999 revised Agreement, particularly with regard to the price exhibits. At my request, the parties continued to seek resolution of their differences.

By conference call on March 30, 1999, the parties stated their desire that the arbitration remain on the existing timeline, with the DAR issued March 30, 1999. By letter dated March 30, 1999, the parties confirmed their statements in the conference call "that both parties were unaware of any additional issues which will arise in this proceeding other than those contained in the Issues Matrix and the briefs." The DAR was filed and served on March 30, 1999.

By letter dated April 5, 1999 on behalf of both parties, Pac-West served a complete Agreement. The April 5, 1999 Agreement resolved all issues raised in Pac-West's letters dated March 19, 1999, and March 24, 1999. Further, the parties confirmed that the only issues to be arbitrated are those presented in the latest issues matrix.

Comments on the DAR were filed on April 9, 1999 by applicant, respondent, and GTE California Incorporated (GTE). This Final Arbitrator's Report is filed and served today, April 23, 1999.

Pursuant to Rule 4.2.1,[4] parties shall file a complete Interconnection Agreement which conforms with the arbitrated outcomes stated in this report within 7 days of today. In addition, parties shall each file a statement with the complete Agreement. (Reporter's Transcript, Volume 5, pages 430-431.) The statement will (1) identify the criteria in the Act and the Commission's Rules (e.g., Rule 4.3.1, referring to Rule 2.18 and Rule 4.2.3) by which the negotiated and arbitrated portions of the Agreement must be tested, (2) state whether the negotiated and arbitrated portions pass or fail those tests, and (3) state whether or not the Agreement should be approved or rejected by the Commission.

3. OVERVIEW

3.1 Major Issues

Pacific says there are two major issues in this proceeding: (1) whether Pacific must pay reciprocal compensation to Pac-West for termination of traffic to Internet Service Provider (ISP) customers of Pac-West and (2) what compensation is due Pacific for transporting Pac-West's Type 6 calls since these calls, according to Pacific, are not local.[5] Pacific says the second issue centers on whether it is appropriate to label ISP-bound traffic originated by a Pacific end-user and delivered by Pacific to Pac-West as "local." These major issues are primarily the subject of Issues 1A, 1B, 2, 3, and, to a lesser extent, other issues, as discussed below.

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[4] Resolution ALJ 174, Revised Rules Governing Filings Made Pursuant to the Telecommunications Act of 1996.

[5] Pac-West's Type 6 service provides a local telephone number to an ISP customer of Pac-West who is located at a site other than in the local exchange where the ISP desires a local presence.

3.2 Stay the Course

This decision essentially "stays the course" on the major issues until the Federal Communication Commission (FCC) and the Commission resolve the fundamental issues of (1) treatment for calls to ISPs and (2) the routing and rating of calls. Both agencies are in the process of further consideration of these matters.[6]

Adoption of Pacific's position on the major issues (i.e., definition of local calls, definition of toll free service, and treatment of calls to ISPs), would substantially change current relationships and cash flows. Those changes could be very harmful to rural customers of ISPs whose calls are carried to ISP customers of Pac-West, as well as harmful to Pac-West. It would be inequitable and inefficient to harm those ratepayers and Pac-West now if the FCC and the Commission soon validate Pac-West's position. On balance, the inequities and inefficiencies, if any, that will continue by adopting Pac-West's position until possibly reversed by the FCC and Commission are less than the inequities and inefficiencies, if any, that would result from now finding against Pac-West if the FCC and Commission eventually validate Pac-West's position. As a result, in my judgment, retaining the status quo for the interim on these matters is reasonable,

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[6] The FCC recently addressed treatment of calls to ISPs, and issued a notice of proposed rulemaking to provide for further consideration. (Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68; adopted February 25, 1999.) The Commission has taken comments in Rulemaking 95-04-043 and Investigation 95-04-044 (the "local competition" proceeding) on proper treatment of routing and rating, plus inter-carrier compensation. (See D.97-12-094 and D.99-02-096.) Further, an application for rehearing of D.98-10-057 is pending. In considering whether or not to grant rehearing, the Commission will have an opportunity to re-examine its position on jurisdiction over traffic between telephone customers and ISPs, and the relationship of the Commission's policy to that of the FCC as expressed in the FCC's February 25, 1999 Declaratory Ruling and Notice of Proposed Rulemaking.

since the FCC and the Commission are scheduled to make the necessary decisions in the reasonably near future.

At the same time, the equities and efficiencies are reasonably balanced by adopting Pacific's position on the term of the contract. In this way, if the FCC and Commission decisions are delayed, the parties and the Commission will have another opportunity to review the agreement and the balance of equities and efficiencies within 2 years. The balance is also made reasonable by the adoption of Pacific's proposal for modification of the contract.

The issue of compensation is decided solely on the merits. I note, however, that the resulting prices for termination under the arbitrated Agreement compared to the existing agreement are 6.6% less for call setup, and 85% less for minutes of use. This has the effect of further balancing the equities and efficiencies during the interim until the FCC, the Commission, and the courts resolve inter-carrier compensation for calls to ISPs, as well as routing and rating issues.

Pacific alleges that in determining the issues herein its revenues must be considered, citing D.98-10-057 in support. Pacific alleges that the revenues it receives on calls to ISPs do not recover Pacific's costs. This fact supports Pacific's position on the threshold issues, according to Pacific.

To the contrary, D.98-10-057 provides that where reciprocal compensation applies, there is nothing discriminatory in requiring that reciprocal compensation apply to ISP traffic. D.98-10-057 continues:

> "If the termination charge is not set at a level which corresponds to the costs incurred in terminating a call, the proper remedy is not to void the requirements of the interconnection agreement prescribing recovery of a termination charge. Rather, the proper remedy would be for the termination charge to be negotiated between the parties to recognize the appropriate costs of call termination and in view of the

> corresponding revenues received by the carrier on whose network the call is originated. ILEC [incumbent local exchange carrier; sic] can renegotiate the interconnection agreements when they terminate to achieve this outcome." (D.98-10-057, mimeo., pages 18-19.)

The direction clearly involves negotiations. The parties here were unable to negotiate termination charges.

In comments on the DAR, Pacific alleges that the adopted result is not really "stay the course" because Pacific says it is not now paying Pac-West reciprocal compensation. While Pacific may be right that it is not now paying Pac-West reciprocal compensation, that nonpayment is by Pacific withholding payment.[7]

The "stay the course" approach adopted here does not address the merits of pending complaint cases. Rather, it simply implements the status quo. Contrary to Pacific's position, I believe it is improper to change the status quo before the FCC and the Commission each conclude their policy-making proceedings.

Pacific alleges the DAR and Pac-West confuse competitive local exchange carriers (CLECs) with ISPs. Pacific says Pac-West is a CLEC, not an ISP. Rather, Pacific says Pac-West is a CLEC which chooses to serve ISPs. Pacific says Pac-West must be held accountable as must any CLEC or ILEC.

I agree. The decisions made herein are all in the context of telecommunications traffic between two telecommunications companies, neither one of whom is an ISP. Pac-West is held accountable herein as is any CLEC.

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[7] Pacific's nonpayment is being litigated in Case No. 97-11-034.

4. ISSUES

Attachment A is the parties' Statement of Unresolved Issues. The Statement identifies the issues, and the exact language recommended by the parties (which is not repeated for each issue herein).

4.1 Definition of Local Traffic

Issue 1A: Should the categorization of "local" traffic be based on the rate centers of the NPA-NXXs of the calling and called telephone numbers or the actual geographic locations of the calling and called parties?

Positions

Pacific contends that local calls must be actually originated by, and terminated to, parties physically located within the 0-12 mile local calling area. Specifically, Pacific proposes for the definition of local call:

> "'Local Calls' are defined as all 0-12 mile calls measured from the originating party's rate center location to the terminating party's rate center location. Local Calls must be actually originated by and actually terminated to parties physically located within the same 0-12 mile local calling area. Calls terminated to numbers which are assigned to a rate center within a local calling area but where the terminating party is physically located outside the local calling area are not considered local calls."

Pac-West contends that local calls are not influenced by whether the routing point of an NPA-NXX is different than the rate center of that NPA-NXX, or by the physical location of the calling or called parties. Specifically, Pac-West proposes for the definition of local call:

> "'Local calls' are as defined by the Commission. Local calls currently include all 0-12 mile calls based on the rate centers of the originating the terminating NPA-NXXs of the callers, irrespective of whether the routing point of an NPA-NXX is different than the rate center of that NPA-NXX (these include but are not limited to ZUM Zone 1 and ZUM Zone 2 calls) and, where established in incumbent LEC tariffs, ZUM Zone 3 and Extended Area Service (EAS) calls."

Discussion

Pac-West's definition is consistent with Commission and industry practice of defining local calls based on rate centers. Therefore, I adopt Pac-West's definition.

Pacific cites its tariffs in support of its position. Specifically, Pacific says its tariff defines a "local call" as:

> "A completed call or telephonic communication between a calling station and any other station within the local service area of the calling station."

Pacific says its tariff defines "local service area" as:

> "An area within which are located the stations which customers may call at exchange rates, in accordance with the provisions of exchange tariffs."

Thus, Pacific concludes that calls must be actually originated by, and terminated to, parties physically located within the local calling area.

To the contrary, exchange rates apply in exchanges. Exchanges are defined in Pacific's tariff as:

> "A telephone system providing service within a specified area within which communications are considered exchange messages, except those messages between toll points."

That is, exchange messages are messages except those between toll points. A toll message is defined as:

> "A completed call or telephonic communication between two exchange stations located in different local service areas, between toll stations, or between a toll station and an exchange station to which rates are applicable in accordance with the provisions of the toll rate tariff."

As the Commission says in D.99-02-096:

> "Based on this definition [of toll message], for a call to qualify as a 'toll message,' the 'exchange stations' or telephone equipment of the calling and called parties must be physically located in geographically separate local exchanges. In order to determine whether a particular call between exchange stations located in separate exchanges qualifies as a toll call, we refer to the rating provisions of the toll rate tariff, as directed in the above-referenced tariff language. The applicable provisions for the rating of toll calls appear in Pacific's Tariff Section A6, 'Message Telecommunications Service.' Under Subsection 6.2.1.A.4a(1), entitled Method of Applying Rates, the tariff prescribes that: 'Toll rates between points (cities, towns, or localities) are based on the airline distance between *rate centers*.'
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> "Therefore, based on this provision of the toll tariffs, we conclude that the tariffs do in fact prescribe call rating based on the distance between the applicable rate centers of the calling and called parties. The toll tariff thus specifies that it is the *rate center*, not the physical location of the parties' terminal equipment, that is used to measure the distance for call rating purposes." (D.99-02-096, mimeo, page 10.)

Thus, the application of the tariff must be understood in the context of the entire tariff. The determination of whether a call is a local call or a toll call is a function of the rating provisions of the tariff. Toll calls are rated based on the airline distance between rate centers. That is, the tariff prescribes call rating based on the distance between rate centers of the calling and called parties, not their physical location.

Moreover, as Pac-West testified, general application of Pacific's proposal would require industry-wide restructuring. Pacific's proposal would require each local exchange carrier to develop knowledge of the actual physical location of both the calling and called parties for every telephone call. The procedure used throughout the industry, however, is to rate calls as local or toll based on the distance between rate centers associated with the calling and called parties' telephone numbers. There is no practical alternative at this time to the rate center-based method of rating calls.

The local exchange routing guide (LERG) [8] is maintained at the six digit (i.e., NPA-NXX), or rate center, level. Pacific's proposal would require the LERG to include all ten digits associated with each call, and the vertical and horizontal coordinates associated with the location of the equipment associated with each ten digit number. No evidence was presented here of any industry plan to expand the LERG to ten digits. To rate calls based on actual physical location (i.e., 10 digits) would involve an exponential increase in the amount of data, as well as the processing of that data, if such rating could be done at all.

As a practical matter, it is impossible to know the physical locations of all calling and called parties. Calls to corporate PBXs or "home banking systems" may in turn be connected to anywhere in the private corporate network (which may be hundreds of miles away from the location of the local NPA-NXX). Such calls do not provide the LEC with any information concerning the ultimate termination point of these calls. Similarly, it is impossible to know the actual physical location of a customer using a wireless (i.e., cordless) telephone that allows the end-user to be over a mile away from the base station.

While there may be methods to overcome these difficulties, Pacific does not adequately explain here how this could be accomplished. Moreover, Pacific's

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[8] The LERG is a guide used by the entire industry that provides rate center and routing information so that calls may be completed.

proposed definition is contrary to Commission and industry practice for call rating, and must be rejected.

Pac-West's definition includes the phrase "...irrespective of whether the routing point of an NPA-NXX is different than the rate center of that NPA-NXX." This phrase may make the definition needlessly complex. In adopting Pac-West's definition, however, I include this phrase. I do so because respondent says the purpose is as clarifying language, not to propose any new or different manner of defining local calls. Rather, respondent says the phrase merely makes explicit that which the Agreement already provides. Specifically, Section 1.42 of the Agreement defines "routing point," and states that the routing point need not be the same as the rating point of an NPA-NXX or located in the same rate center as the rating point. Since this phrase is not intended to introduce any additional controversy, the entire definition as proposed by Pac-West is adopted.

In comments on the DAR, Pacific challenges the statement that under its proposal industry-wide restructuring would be necessary, and that the actual physical location of the calling and called parties would be required. Rather, Pacific says the called number would be rated to the rate center where the call is delivered. Pacific fails to explain, however, how one determines where the call is delivered. Pacific argues, for example, that calls to ISPs can be delivered anywhere in the world. Pacific says corporate PBXs or "home banking systems" may choose to carry the call further than the originally called station. Without Pacific explaining how it would propose to determine where the call is terminated, Pacific's proposal is incomplete.

In further comments on the DAR, Pacific says:

> "By filling in a box on the North American Numbering Plan/LERG form, Pac-West tricks the normal rules and dictates the 'rating center' of these numbers, and at the same time dictates that calls to these

> numbers be routed to a totally different location, some 50, 100 or 200 miles away from the assigned 'rating center.' As part of its 'stay the course' approach, the DAR would continue this game until this 'rating and routing' issue is generically resolved by the Commission." (page 4.)

To the contrary, the practice employed by Pac-West is, in my view, best addressed by resolving inter-carrier compensation, not the adoption of a unique definition of local call in this one Agreement.[9] The definition of local call adopted herein is consistent with Commission and industry practice. Inter-carrier compensation is before the Commission in the local competition proceeding, and a decision is expected reasonably soon. It would be premature to adopt a different policy here than the Commission has applied in similar cases when the matter is before the Commission generically.

Also in comments on the DAR, Pacific says it is a threat to current pricing policies to allow calls to be rated as local based on rate centers when the call is actually terminated beyond the local calling area. Pacific says this will create mischief that will facilitate bypassing of toll charges through the purchase of phone numbers. Even if true, the solution is not to adopt a unique definition of local call to achieve a desired type of inter-carrier compensation in this one Agreement. Rather, the solution is to directly resolve the compensation issue. As stated above, the best practice is not to disturb current Commission policy on this matter until the Commission has examined the matter generically.

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[9] The Commission similarly said that if "the termination charge is not set at a level which corresponds to the costs incurred in terminating a call, the proper remedy is not to void the requirements of the interconnection agreement prescribing recovery of termination charges. Rather, the proper remedy would be for the termination charge to be negotiated between the parties..." (D.98-10-057, mimeo., page 18.)

Pacific also says in comments on the DAR that:

> "The basis for measuring distance between two stations is the airline mileage from the rating center of the calling station to the rating center of the called station." (Page 8.)

That is, distances are not measured between stations, but between rating centers. Reliance on rating centers is precisely the outcome adopted here. Again, the solution is not to adopt a unique definition of local call in this one Agreement.

In comments on the DAR, GTE asserts the DAR fails to recognize the arbitrage opportunity that CLECs have by seeking reciprocal compensation for ISP-bound traffic when a local call is defined by the rate center of the NXX codes. GTE asserts it is a perversion of the access charge regime (wherein CLECs are exempt from paying access charges to ILECs for ISP-bound calls) to interpret the exemption to permit the collection of compensation for local traffic, in addition to the avoidance of access charges for long distance traffic. GTE concludes that the DAR perpetuates this perversion.

To the contrary, the result adopted herein maintains a consistent definition of local traffic, along with application of current Commission policy, until the matter is examined and resolved in FCC and Commission generic proceedings. To the extent the "perversion" continues, the balance of equities and efficiencies justifies maintaining the status quo for the interim.

4.2 Definition of Toll Free Service

> Issue 1B: Related to the definition of local calls, what should be the definition of toll free service?

Positions

Pacific's proposed agreement includes a definition of "toll free service." Pac-West proposes additional language to make explicit that Pac-West's Type 6 service is not toll free service. Pacific argues that Pac-West's Type 6 service is a toll free, 800-like, service.

Discussion

Pac-West's definition is consistent with seven digit dialing. It is also consistent with the definition of "local calls." Therefore, I adopt Pac-West's definition.

There can be no argument that Pac-West's Type 6 service is a toll free service. That is its entire essence. It is marketed to ISPs so that the ISPs have a local presence in various communities throughout the state. In that way, the customers of the ISP do not incur toll charges to reach the ISP for internet access.[10]

Nonetheless, Pac-West contends Type 6 service is not 800-like because it requires only seven digit dialing, consistent with the caller understanding the call to be local. Pac-West says Type 6 service does not require 10 digit dialing, nor does it rely on a database to translate the called number into another number to route the call, which are both characteristics of 800 service. Pac-West is right.

Further, the parties agree on the first sentence of the definition: "'Toll free service' means service provided with any dialing sequence that invokes toll free, i.e., 800-like, service processing." While "any dialing sequence" may initially suggest that the definition is very expansive, the definition is not without limitation. The term "i.e." means "that is." As such, the toll free service must be a dialing sequence that invokes toll free, that is 800-like, service processing.

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[10] "Testimony in the record is clear that this type of 'local presence' is critical to the marketing plans of ISPs because, among other reasons, Internet users are unlikely to make toll calls in order to access the Internet for extended periods." (Pac-West Brief, page 14, citing Exhibit 30 at page 5.)

In contrast, the definition could have used "e.g.," which means "for example." In that case the definition would mean any dialing sequence that invokes toll free, for example 800-like, service processing. This would be a broader definition, and would not limit the dialing sequence to 10 digit dialing or reference to a database.

Pac-West proposes to add additional language to the end of the second sentence of the definition:

> toll free service "...excludes services using standard NPA-NXX dialing patterns, irrespective of whether the routing point of the NPA-NXX is a different rate center than the rating point of that NPA-NXX."

Pac-West says it does not disagree with Pacific's definition, but "merely proposes to add clarifying language." (Pac-West brief, page 17.)

While not a toll free service as defined, the essence of Type 6 service is that there are no toll charges, as explained above. In that sense, Type 6 service is toll free. Nonetheless, the Pac-West proposed additional language parallels that adopted for the definition of local calls. To the extent the routing and rating matter may be reversed by subsequent FCC or Commission order, it is subject to the Agreement's provisions regarding modification of the Agreement (Issue 20.) For consistency with the definition of local calls, Pac-West's additional language is adopted.

Further, both Pacific and Pac-West agree that the definitions of local calls (Issue 1A) and toll free service (Issue 1B) must be consistent. That is, according to the parties, the arbitrated result must either adopt both of Pacific's proposed definitions, or both of Pac-West's proposed definitions. Otherwise, both parties contend that the agreement will be internally inconsistent. As such, I adopt

Pac-West's definition because the parties agree the definitions should be adopted in parallel, and I have adopted Pac-West's definition of local calls.

4.3 Internet Service Provider Traffic

Issue 2: Is local traffic which Pac-West delivers to its internet service provider customers subject to the Agreement?

Positions

Pacific seeks contract language saying that the parties agree internet traffic is not subject to local reciprocal compensation. Pacific's proposal also says that, in the event the FCC or Commission further rules that local reciprocal compensation is required, meet point billing should be adopted because it adequately considers the revenues that the originating carrier receives for each call. Pac-West contends all local calls, including those to ISPs, are subject to payment of local reciprocal compensation.

Discussion

Pac-West's clause is adopted, as modified below, for the following reasons.

The definition of local calls is decided in Issue 1A above. As a result, calls to ISPs are local if the rate centers of the originating and terminating NPA-NXXs are within the local area, irrespective of whether the routing point is different than the rate center. FCC rules require reciprocal compensation for the termination of local telecommunications traffic. (47 C.F.R. Section 51.703.)

Bill and keep is an option when the traffic is roughly balanced and when no showing has been made pursuant to 47 C.F.R Section 51.711(b)—that is, seeking to justify asymmetrical rates. (47 C.F.R. Section 51.713(b).) Bill and keep is not an option here because the traffic is not roughly balanced, and a showing was made (although rejected below) pursuant to 47 C.F.R. Section 51.711(b).

Pacific proposes meet point billing. Meet point billing generally applies when an interexchange carrier is involved, and there is a local exchange carrier at both the originating and terminating ends. That is not the case here.

Moreover, as Pac-West states, D.98-10-057 finds that a call to an ISP is a local call "if the rate centers associated with the telephone number of the end user originating the call and the telephone number used to access the ISP modem lies [sic] within a single local calling area." (Finding of Fact 11, mimeo, page 21.) Therefore, Pac-West's proposed clause is consistent with resolution of Issue 1A and Commission decisions, while Pacific's proposed clause is not.

Pacific points out that D.98-10-057 is subject to an application for rehearing. As such, Pacific says it should not be relied on here.

While Pacific is right that D.98-10-057 is the subject of an application for rehearing, the order is not stayed. Rather, it is an effective order. It is the currently effective law and policy guidance of the Commission applicable to this arbitration, until such time as the Commission elects, if it does, to modify it on rehearing. I am, therefore, guided by that order.

According to Pacific, a recent FCC order finds that ISP-bound traffic is non-local, rejects the two-component theory for calls to ISPs, applies a one-communication theory, and finds that the reciprocal compensation requirement of Section 251(b)(5) of the Act does not govern inter-carrier compensation for ISP-bound traffic.[11] Pacific contends D.98-10-057 is based on a two-call theory and, therefore, can no longer be followed. Rather, as a result of the FCC order, Pacific argues that calls to ISPs must now be understood as non-local interstate

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[11] FCC Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, adopted February 25, 1999.

calls, that the one-communication theory must apply, and that reciprocal compensation requirements cannot be mandated. Pacific concludes that ISP traffic cannot be subject to reciprocal compensation and, as interstate traffic, meet point billing as a minimum is appropriate.

Pacific is right that the recent FCC order generally finds a call to an ISP is not composed of two parts, but is one call. Moreover, the FCC generally finds that such calls are largely interstate. At the same time, however, the FCC states that it has had a longstanding policy of treating this traffic as local. (Id., paragraph 24.) Further, the FCC emphasizes that it has treated, and continues to treat, ISP-bound traffic as local for the purpose of exempting ISPs from access charges. (February 25, 1999 FCC Declaratory Ruling, paragraphs 16, 20, and 23.) In addition, the FCC states that:

> "Even where parties to interconnection agreements do not voluntarily agree on an inter-carrier compensation mechanism for ISP-bound traffic, state commissions nonetheless may determine in their arbitration proceedings at this point that reciprocal compensation should be paid for this traffic...As we observed in the *Local Competition Order*, state commission authority over interconnection agreements pursuant to section 252 'extends to both interstate and intrastate matters.' [footnote deleted.] Thus the mere fact that ISP-bound traffic is largely interstate does not necessarily remove it from the section 251/252 negotiation and arbitration process. [Footnote deleted.] However, any such arbitration must be consistent with governing federal law. [Footnote deleted.] While to date the Commission has not adopted a specific rule governing the matter, we note that our policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that such compensation is due for that traffic." (Id., paragraph 25.)

At this point, reciprocal compensation has not been eliminated as a compensation option by the FCC. While the FCC says the outcome of this arbitration must be consistent with federal law, the FCC also says it "currently has no rule addressing the specific issue of inter-carrier compensation for ISP-bound traffic." (Id., paragraph 26.) Therefore, nothing about the result of this arbitration is inconsistent with governing federal law.

The FCC continues: "Until adoption of a final rule, state commissions will continue to determine whether reciprocal compensation is due for this traffic." (Id., paragraph 28.) The determination here is to "stay the course" pending further decisions by the FCC and this Commission on the proper compensation for ISP-bound traffic, and the proper treatment of rating and routing of calls. This outcome does not conflict with any federal law, is equitable, is reasonable, and is adopted.

Further, as Pac-West points out, the FCC states that when considering the reasonableness of reciprocal compensation for ISP-bound traffic, state commissions may consider several factors. (Id., paragraph 24.) First, state commissions may consider whether incumbent LECs serving ISPs have done so out of intrastate or interstate tariffs. Pacific serves its ISP customers out of intrastate tariffs.

Second, state commissions may consider whether the revenues associated with those services are counted as intrastate or interstate revenues. Pacific's service to ISPs generates intrastate revenues.

Third, states may consider whether incumbent LECs and CLECs made any effort to meter this traffic or otherwise segregate it from local traffic, particularly for the purpose of billing one another for reciprocal compensation. Pacific does not regularly monitor, track, or segregate the amount of traffic delivered to ISPs served by Pacific.

Fourth, states may consider whether, in jurisdictions where incumbent LECs bill their end users by message units, incumbent LECs have included calls to ISPs in local telephone charges. Pacific bills its customers at local rates for

ISP-bound calls within the caller's local area, including message units if the caller is not on flat rate service.

Finally, if ISP traffic is not treated as local and subject to reciprocal compensation, states may consider whether incumbent LECs and CLECs would be compensated for this traffic. Pacific's proposal that meet point billing apply for ISP traffic might satisfy this factor. Four of the five FCC-suggested factors, however, generally support reciprocal compensation for local traffic. The fact that the last factor might apply does not outweigh the other reasons for continuing reciprocal compensation for local traffic in the interim (pending further FCC and Commission orders on the matter).

In comments on the DAR, Pacific alleges that reliance on these factors is misplaced. Rather, Pacific says the factors were proposed by the FCC as potentially relevant in construing parties' agreements, and in ascertaining parties' intentions. Pacific says that is not the case here, since there is no question of contract interpretation. To the contrary, while illustrative for negotiated contract interpretation, the FCC did not limit the use of these factors to only interpretation of negotiated contracts. Further, use of the factors here by themselves is illustrative and informative, not dispostive.

Another reason to reject Pacific's proposal to treat ISP traffic separately from other traffic is that Pacific does not regularly track ISP calls on its own network, and it would be similarly difficult for Pac-West to track ISP calls on its network.[12] Regulation generally avoids differentiating traffic, or discriminating

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[12] In comments on the DAR, Pacific says when necessary it has tracked ISP calls, and it will continue to do so when necessary. (Comments, page 17.) Thus, it is not now a regular practice for any routine purpose.

between traffic, based on the type of call. It would be undesirable to abandon that longstanding principle here.

Even if ISP traffic could be reasonably identified, there would be incentives for Pac-West to understate the amount of such traffic, or for Pacific to overstate the amount of such traffic. There would inevitably be disputes over what ISP traffic was truly local (e.g., terminated at the ISP's local computer without access to the internet) versus the ISP traffic (or part of an ISP call) that accessed the internet and became interstate. Resolving these disputes, and implementing enforcement of the results, could be difficult and controversial. It is undesirable to arbitrate a result that invites dispute based on specific implementation details.

Pac-West's proposed contract clause contains a final sentence that must be rejected. Pac-West's proposed final sentence reads:

> "However, in the event the CPUC rules that the preceding sentence of this Agreement can not be enforced and that local reciprocal compensation is not permissible for such Local Calls despite the preceding sentence, and all administrative and judicial appeals of any such ruling have been exhausted, the parties shall negotiate a modification to this agreement to incorporate such ruling on a prospective basis, including the appropriate rate of any such compensation."

This sentence is rejected because it is inconsistent with the resolution of Issue 20 below. Specifically, the agreement shall be brought into conformance with subsequent actions of the Commission, FCC, other regulatory agencies, state and federal legislatures, and the courts. Neither Pacific's nor Pac-West's proposed clause regarding Issue 20 require that an amendment to this Agreement await resolution of all administrative and judicial appeals. Further, my decision herein to "stay the course" pending resolution of threshold issues at the FCC and the Commission is not intended to be until all appeals are exhausted. Rather, this arbitrated Agreement should be brought into conformance, and made consistent, with subsequent regulatory, legislative, and court decisions when those decisions are effective, unless stayed, consistent with resolution of Issue 20 below (Section 4.14.)

In comments on the DAR, Pacific alleges that the February 25, 1999 FCC Declaratory Ruling finds ISP traffic to be interstate. Pacific further claims that Pac-West is compensated by its ISP customers, and need not be further compensated by reciprocal compensation. Pacific concludes that the DAR violates the FCC's Declaratory Ruling and governing federal law, and that reciprocal compensation cannot be adopted here.

To the contrary, the FCC addressed these points it its Declaratory Ruling and was not persuaded. The FCC concluded that:

> "Although reciprocal compensation is mandated under section 251(b)(5) only for the transport and termination of local traffic, [footnote deleted] neither the statute nor our rules prohibit a state commission from concluding in an arbitration that reciprocal compensation is appropriate in certain instances not addressed by section 251(b)(5), so long as there is no conflict with governing federal law. [Footnote 87, deleted here.] A state commission's decision to impose reciprocal compensation obligations in an arbitration proceeding—or a subsequent state commission decision that those obligations encompass ISP-bound traffic—does not conflict with any Commission rule regarding ISP-bound traffic. [Footnote 88, deleted here.]" (FCC Declaratory Ruling dated February 25, 1999, paragraph 26.)

Pacific points out that, according to footnote 87 of the FCC's Declaratory Ruling, reciprocal compensation requirements of Section 251(b)(5) of the Act and Commission rules do not govern inter-carrier compensation for ISP traffic. While correct, footnote 87 also says: "As discussed, *supra*, in the absence [of] a federal rule, state commissions have the authority under section 252 of the Act to determine inter-carrier compensation for ISP-bound traffic." (Id.)

The FCC continues:

> "We recognize that our conclusion that ISP-bound traffic is largely interstate might cause some state commissions to re-examine their conclusion that reciprocal compensation is due to the extent those conclusions are based on a finding that this traffic terminates at an ISP server, but nothing in this Declaratory Ruling precludes state commissions from determining, pursuant to contractual principles or other legal or equitable considerations, that reciprocal compensation is an appropriate interim inter-carrier compensation rule pending completion of the rulemaking we initiate below." (Id., paragraph 27.)

It is these equitable and other considerations, as explained in this Final Arbitrator's Report, which lead me to conclude that reciprocal compensation is appropriate as an interim measure pending completion of further consideration by the FCC and Commission. Pursuant to the arbitrated resolution of Issue 20 (Section 4.14 below), the Agreement will be made consistent with forthcoming Commission and FCC decisions on this issue without unreasonable delay.

Pacific argues that Section 251(b)(5) of the Act imposes a duty on Pacific to pay reciprocal compensation only for the transport and termination of telecommunications. Pacific asserts that the FCC Declaratory Ruling makes clear that ISP-bound calls do not terminate at the ISP node. Pacific concludes that, under current governing federal law, it cannot be required to pay reciprocal compensation for termination.

To the contrary, the FCC Declaratory Ruling also makes clear that the Commission may continue to apply reciprocal compensation in the interim. (Id., paragraph 27.) The FCC says that "[u]ntil adoption of a final rule, state commissions will continue to determine whether reciprocal compensation is due for this traffic." (Id., paragraph 28.)

In further comment on the DAR, Pacific asserts that reliance on the FCC's treatment of ISP-bound traffic as local for the purpose of exempting ISPs from access charges is misplaced. Rather, Pacific says this is backwards, because the FCC allows the exemption only because the FCC has found the traffic to be interstate. If the traffic is interstate, Pacific concludes reciprocal compensation cannot be mandated.

To the contrary, the FCC says: "[a] state commission's decision to impose reciprocal compensation...does not conflict with any Commission rule regarding ISP-bound traffic." (Id., paragraph 26.) In fact, in a footnote to that statement, the FCC says: "As noted, in other contexts we have directed states to treat such traffic as local." (Id., footnote 88.)

In comments on the DAR, GTE says reliance on paragraphs 21 through 27 of the February 25, 1999 FCC Declaratory Ruling is misplaced for two reasons. First, GTEC asserts that the FCC cannot delegate its jurisdiction to the states to decide inter-carrier compensation for interstate traffic. Further GTE says it has filed a petition with the United States Court of Appeals for the District of Columbia Circuit seeking review of the right of state commissions to decide compensation for interstate traffic. Even if GTE is right, and its petition has been filed, the Declaratory Ruling is unstayed pending GTE's appeal. As such, to the extent it addresses jurisdiction, its findings remain in effect.

Second, GTE asserts the FCC's Declaratory Ruling is not binding, but is simply dicta. Even if true, to the extent the FCC's jurisdiction must be considered and addressed, the FCC's Declaratory Ruling provides potentially useful guidance on the state and federal relationship.

Therefore, for all the reasons stated above, Pacific's proposed contract clause is rejected, and Pac-West's proposed contract clause is adopted, except for Pac-West's second proposed sentence.

4.4 Compensation

Issue 3: What is the proper compensation to be paid to Pac-West for its termination of local traffic subject to the Agreement?

Positions

Pacific recommends that Pacific pay Pac-West the same rates that Pac-West will pay Pacific (i.e., symmetrical rates). Pac-West recommends adoption of the results of its cost study, justifying higher rates paid by Pacific to Pac-West (i.e., asymmetrical rates). Alternatively, Pac-West recommends adoption of total element long run incremental costs (TELRICs) from the Open Access and Network Architecture Development (OANAD) proceeding (Rulemaking 93-04-003/Investigation 93-04-002), plus the AT&T arbitrated mark-up. [13]

Discussion

The rates will be symmetrical. Pacific's proposed rates are adopted.

FCC regulations generally require termination rates to be symmetrical. (47 C.R.F. Section 51.711(a).) If proven by an appropriate cost study, rates may be asymmetrical:

> "A state commission may establish asymmetrical rates for transport and termination of local telecommunication's traffic only if the carrier other than the incumbent LEC (or the smaller of two incumbent LECs) proves to the state commission on the basis of a cost study using the forward-looking economic cost based pricing methodology described in §§ 51.505 and 51.511 of this part, that the forward-looking costs for a network efficiently configured and operated by the carrier other than the incumbent LEC (or smaller of two incumbent LECs), exceed the costs incurred by the incumbent LEC

[13] In its brief, Pac-West clarifies that this means rates based on the Pacific cost study results adopted in D.98-02-106, plus a markup of 21% for common costs. (Brief, page 43.)

> caused by differing loop lengths are the most significant cost factor, switching costs are less significant than they would be in, for example, a cost model to determine unbundled network element switching and transport costs." (Id., paragraph 75.)

That is, where switching costs are more significant, a cost model to determine switching costs would need more scrutiny.

FCC regulations require that the cost study justifying asymmetrical rates be based on TELRIC. (47 C.F.R. 51.711(b).) As Pacific points out, the FCC Order does not say that the HCPM complies with TELRIC requirements, and the Order does not use the terms "TELRIC" or "incremental costs."

FCC regulations require that the cost study necessary to justify asymmetrical rates be based on the network costs of the carrier other than the incumbent LEC. In contrast, the HCPM determines "costs on a wide scale basis," not on a carrier-specific basis. (Id., paragraph 12 and footnote 24.)

Universal services traffic is traffic originated by customers of the studied universal services provider. Pacific correctly says that the costs of terminating other traffic are not currently considered costs of universal service, and are not addressed in the FCC Order.

Moreover, the FCC Order does not address or adopt input values. Rather, the model is, at best, a proxy on a widescale basis using generic, nonspecific default values. It is not a model to derive individual utility, network-specific, termination costs.

Pac-West asserts it used inputs specific to Pac-West. To the contrary, nearly every input was the default value, including default inputs for all switch investments, land, construction costs and overheads.

Where Pac-West sought to employ Pac-West-specific input factors, not all were reasonable. For example, switch maintenance was not based on Pac-West information. Rather, it was based on the historic average relationship between

Pacific's embedded switching investment and switching expense obtained from Pacific ARMIS data. ARMIS data is accounting data submitted to the FCC. It represents historic, or embedded, costs, and not forward-looking costs, as required to establish asymmetrical rates.

The HAI model used by Pac-West employs the same maintenance expense factor for traffic-sensitive switching as it does for non-traffic-sensitive switching. Traffic-sensitive switch maintenance expenses are different than non-traffic-sensitive switch maintenance expenses. By not accounting for this difference, the HAI model understates traffic-sensitive switching (e.g., usage) costs, and overstates non-traffic-sensitive switching (e.g., port) costs. As Pacific says, this may explain some of the overstatement in the Pac-West proxy cost results.

Pacific is also correct that Pac-West incorrectly included origination costs in its proposed asymmetrical termination rate. Setting up a call involves more originating end-office switch resources than terminating end-office switch resources. Pac-West used the entire switching cost output of the model. This unreasonably inflates Pac-West's proposed rates for termination.

Moreover, Pac-West used the HAI proxy cost output for the cost of a call placed by a Pac-West customer to a Pac-West customer and represented this as the cost of terminating a call from a Pacific customer. Pac-West's termination costs should not include call origination costs because, on a call placed by a Pacific customer terminated by Pac-West, origination costs are incurred by Pacific. Pac-West has thus used the model output for the switching unbundled network element cost proxy as the termination cost proxy, which it is not. As such, Pac-West included proxy costs for switching functions that are not functions associated with termination. In the process, Pac-West demonstrates that the model is not appropriate for identifying forward-looking termination costs.

Thus, Pac-West proposes using a cost proxy model for a purpose other than that for which it was designed, and for which it was adopted by the FCC. The resulting cost proxies simply have no bearing on Pac-West's TELRICs for termination of local traffic. Pac-West fails to justify asymmetrical rates. Therefore, symmetrical rates must be adopted. Pacific's proposed rates are based on end-office switching costs developed and approved in D.96-08-021, and should be adopted.

If Pac-West's cost study is rejected, Pac-West proposes, in the alternate, that termination rates be based on Pacific's costs adopted in D.98-02-106, plus the AT&T markup of 21%. To the contrary, such rates should not be adopted. First, asymmetrical rates must be based on the costs of the carrier other than the LEC (i.e., based on Pac-West's costs). (47 C.F.R. Section 51.711(b).) Using another carrier's markup is inappropriate.

Second, Pac-West does not provide a price appendix showing the proposed rates, and, as such, the proposal is not adequately specific. The record here simply does not contain the prices proposed by Pac-West and they, therefore, cannot be adopted. Seven pages of prices are attached to the April 5, 1999 version of the Agreement for rates Pac-West will pay Pacific. Pac-West provides no similar price appendix for symmetric prices under its alternative proposal. Rather, Pac-West references a Commission decision regarding costs, suggests others find the relevant costs therein, and then multiply those costs by a markup factor. To the contrary, the burden is on each party to make its proposals specific (e.g., with "dueling clauses" in the statement of unresolved issues.) Pac-West does not meet its burden, there is simply no specific proposal, and Pac-West's alternate recommendation must be rejected.

Third, Resolution ALJ 174 provides that arbitrated rates are subject to update based on the OANAD pricing decision.[16] While TELRIC costs have been recently adopted for Pacific (D.98-02-106), prices have not. In the absence of OANAD prices, it is reasonable to use Pacific's proposed rates. No other specific symmetrical rates are proposed, and presented in a specifically identified price appendix, in this arbitration.

The policy in Resolution ALJ 174 will, of course, be followed. As such, interim rates adopted here will be revised on a going-forward basis to mirror the rates adopted in the Commission's OANAD pricing decision. The pricing phase of the OANAD proceeding is near completion, and rates adopted herein will, therefore, be updated reasonably soon.

In comments on the DAR, Pac-West alleges that rejection of the HCPM based on the relationship of its outputs to FCC cost proxies in 47 C.F.R. Sections 51.505 and 51.513 is misplaced. To the contrary, the result of this arbitration does not rely on any such relationship. The rejection of the HCPM here is unrelated to the cost proxies adopted in FCC regulations.

In further comments, Pac-West says the Commission articulated six reasons for rejecting an earlier version of the HAI model. Of the six reasons, only two affect call termination costs, according to Pac-West.

Importantly, however, of the two items that Pac-West says affect termination costs, one item—switch investment per line—is critical. As explained in Exhibit 24, Pac-West used the default value from the model, not a Pac-West specific input. Switch investment is one of the most critical items for determining termination costs. Pac-West has been in business for several years, and has

[16] Resolution ALJ 174 dated June 25, 1997, page 2

experience buying switches. Pac-West's President testified that Pac-West is a rapidly growing company, and there is every reason to believe it plans to continue that growth. Pac-West would, therefore, be in a reasonable position to determine its own forward-looking switch investment cost for the purpose of a cost study proving the reasonableness of asymmetrical rates. Pac-West failed to do so.

Pac-West also asserts in its comments on the DAR that there is no evidence to support the conclusion that Pac-West improperly treated originating versus terminating costs. To the contrary, the cross-examination cited by Pac-West in support of its position shows Pac-West's witness testified that the question of differences in originating versus terminating costs would best be addressed to someone else, and he was unaware that it would be an issue. (Reporter's Transcript, page 401.) Thus, the testimony cited by Pac-West in support of its proposition is not compelling.

Pac-West also comments that call transport and termination are part of universal service costs. Even if true, nothing in the comments overcomes the FCC's own statement (cited above) that when switching costs are not insignificant, a cost model to determine switching costs would need more scrutiny.

In further comments on the DAR, Pac-West asserts that the logic is flawed regarding whether treatment of traffic-sensitive and non-traffic-sensitive expenses understate or overstate costs. Pac-West says "the record is clear that the Pac-West study does segregate traffic-sensitive from non-traffic-sensitive switch maintenance expenses, and that only the latter were attributed to Pac-West's proposed asymmetric compensation cost and rate." (Comments, page 12.) However, Pac-West continues: "As explained above, Pac-West's asymmetric cost study result reflects only TS [traffic-sensitive] maintenance expenses." (Id.) Pac-West's comments confuse rather than clarify its concern.

In additional comments on the DAR, Pac-West says Pacific has made a proposal in a recent petition for arbitration to use prices consistent with Pac-West's alternate pricing proposal, citing Application 99-03-047 (Pacific Bell petition for arbitration with MFS). Pac-West says it would be both efficient and equitable to implement the same rates here, given Pac-West's pick and choose rights under the Act.

To the contrary, results in this arbitration must be limited to the specific, concrete proposals made herein. If Pac-West may exercise pick and choose rights under the Act to achieve its desired outcome, it may use those rights as and when appropriate. The loss of efficiency and equity, if any, by not adopting those prices here is small.

4.5 Term of Agreement

Issue 4: What should be the term of the Agreement?

Positions

Pacific seeks a two-year term. Pac-West seeks a three-year term.

Discussion

The Agreement shall be for two years. Pacific's proposed clause is adopted.

Pacific is correct that the rapid changes in the marketplace make a two-year term reasonable. Even more importantly, the FCC and Commission are due to reasonably soon decide the threshold issues which underlie this arbitration. While Pac-West is right that Issue 20 addresses modifications to the Agreement in the event of regulatory developments within the term of the agreement, there may be ambiguities or the parties might disagree on the application of those developments. Should there be any ambiguity or dispute, it is reasonable to provide an opportunity for the parties to address the matter in the context of an entirely renegotiated Agreement sooner rather than later. The dispute resolution provisions of the Agreement will not necessarily provide as comprehensive an opportunity.

Should the FCC and Commission decisions be delayed beyond two years for any reason, it is reasonable for the parties to have another opportunity to align the Agreement with whatever is the state of the dynamically changing marketplace and regulation in two years. Thus, two years is more reasonable than three years.

Pac-West contends that the process of negotiating with Pacific for a revised Agreement is very costly to Pac-West. While this may be true, it is simply a cost of doing business for Pac-West in this dynamic and rapidly changing industry, including changing legislative and regulatory requirements.

Moreover, my decision to "stay the course" should be reasonably limited. In that way, it provides both parties an opportunity to address and resolve any alleged inequities and inefficiencies that are not resolved herein without undue delay.

The Commission has already characterized Pac-West's service as "unconventional."[17] The Commission may determine that this "unconventional" service should not stand. If so, a two-year term provides the best balance between all considerations and factors, providing both parties an equal opportunity to take advantage of a total renegotiation given the state of the market and regulation at that time.

4.6 Pick and Choose

Issue 7: What should be the parties' rights under 47 C.F.R. Section 51.809?

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[17] D.99-02-096, Conclusion of Law 5, mimeo., page 22.

Positions

Pacific proposes that either party be allowed to pick and choose among provisions of interconnection agreements. Pac-West proposes that only Pac-West be allowed to pick and choose, that the clause use specific words from the FCC regulations, and that any amendment under this provision be effective 30 days after notice by Pac-West to Pacific of Pac-West's desire for a term from another agreement.

Discussion

Pac-West's proposed clause is adopted as modified below.

Pac-West's proposed clause provides that Pac-West may pick and choose, not Pacific. This is consistent with FCC regulations.[18] (47 C.F.R. Section 51.809.) Pacific's proposed clause would give Pacific pick and choose rights that are not required by FCC regulation, and Pacific makes no compelling argument why it should be given those rights.

Pac-West's proposed clause includes the specific words in the FCC regulations regarding the particular items available and, as such, is reasonable. Pacific makes no compelling argument for its more general language.

[18] The Act says that a local exchange carrier shall make available elements provided under an approved agreement to which it is a party to any other requesting telecommunications carrier. (Section 252(i).) Pac-West is a local exchange carrier. Pacific is a telecommunications carrier. Thus, under the Act, Pacific seemingly has the right it seeks here.

The FCC regulations however, state that ILECs shall make agreement elements available to telecommunications carriers, not that telecommunications carriers shall make elements available to ILECs or other telecommunications carriers. (47 C.F.R. Section 51.809.) Thus, Pacific's proposal fails under FCC regulations.

Pac-West, however, includes a sentence that will be not be adopted. Pac-West proposes that: "Pac-West shall notify Pacific in writing of the terms and conditions which it desires to incorporate into this Agreement, and such incorporation shall become effective thirty days after such notice." This sentence does not recognize that amendments to the Agreement must be approved by the Commission. (Section 252(e) of the Act.) As such, the amendment cannot become automatically effective 30 days after Pac-West notifies Pacific.

Pacific's proposal to reject Pac-West's clause is unreasonable, and Pac-West's proposal for amendments to become automatically effective is also unreasonable. Pac-West's concern, however, should be recognized. The concern is that Pac-West be provided new terms consistent with its pick and choose rights without unreasonable delay. That concern can be satisfied by requiring Pacific to submit an advice letter to the Commission within 30 days of Pac-West's written request to Pacific for amendment pursuant to Pac-West's pick and choose rights. Therefore, the adopted sentence is: "Pac-West shall notify Pacific in writing of the terms and conditions which it desires to incorporate into this Agreement, and Pacific shall submit the request by advice letter to the Commission for approval within 30 days after such notice from Pac-West." The advice letter will then become effective consistent with Commission rules for advice letters.

Finally, I note the following drafting matter. The adopted Pac-West proposed clause, including the modified sentence, refers to Pac-West rather than CLEC. For consistency with other elements of the Agreement, parties are encouraged to consider replacing Pac-West with CLEC here, and include that change with the final conformed interconnection agreement submitted for Commission approval within seven days of the filing of the Final Arbitrator's Report.

4.7 Application of Rates

Issue 8A: Should rates apply only to local traffic or to all traffic?

Positions

Pacific proposes that the Agreement make clear in Section 5.3.2.1 that the rates, terms, and conditions in Section 5.3 apply only to the termination of local traffic, unless otherwise noted in Section 5. Pac-West proposes that the rates, terms, and conditions in Section 5.3 apply to all traffic.

Discussion

Pacific's clause is adopted. Section 5.3 is titled "Reciprocal Compensation for Termination of Local Traffic." Pac-West's proposal conflicts with the purpose of the section as expressed in its title. Further, as Pacific points out, Section 5.3 should only apply to local traffic unless Section 5 notes otherwise. Section 5 also addresses compensation for transit traffic, interexchange traffic, and switched access traffic. Reciprocal compensation should not apply to any traffic other than local traffic unless the parties have so agreed. Pac-West's language is overly broad.

Pac-West contends that the reference to applicable rates should be clear and unambiguous, as accomplished by its proposal. This argument is not compelling. Rather, Pacific's proposed clause is equally (if not more) clear and unambiguous, and more reasonable.

Pacific argues that its language should be adopted because reciprocal compensation should only apply to truly local traffic, not ISP-bound traffic. To the contrary, adoption of Pacific's clause does not excuse Pacific from paying reciprocal compensation for ISP-bound traffic when that traffic is local, consistent with the arbitration of Issues 1A, 1B and 2.

4.8 Setup Charges per Call or per Call Attempt

Issue 8D: Should setup charges be per call or per call attempt?

Positions

Pacific argues compensation should be paid per call. Pac-West believes compensation should be paid per call attempt.

Discussion

Compensation for setup shall be by call, not call attempt. Pacific's clause is adopted.

Setup charges should only apply if the call is completed. This is custom and practice in the industry, and, according to Pacific, the method of compensation approved by the Commission in every interconnection agreement containing rate elements. For example, the existing agreement between Pacific and Pac-West is based on calls, not call attempts. Pac-West does not identify any approved agreements to the contrary.

Terminating charges for switched access follow the same practice, and Pacific's switched access tariff specially provides that terminating charges begin only when the user answers the call. This is so because, in the case of measured service, the end user only pays for completed calls. As a result, the end user's carrier only has revenue to share with other carriers if the call is answered.

Moreover, as a practical matter, Pacific's billing system is not able to track call attempts on local calls. While Pac-West asserts Pacific's tariff contains a formula for determining call attempts when necessary, Pac-West makes no compelling showing that it would be reasonable to apply that formula (which is in Pacific's switched access tariff) to local calls.

Pac-West alleges it incurs costs to process calls whether or not the call is completed and, as such, should be paid for call attempts. Pac-West says it has not agreed to reflect these costs in its call rates, as, according to Pac-West, Pacific has decided to do. The decision here applies compensation based on Pacific's proposed rates. Those rates are based on calls, not call attempts. Consistency requires that payment be based on calls, not call attempts.

4.9 Reciprocal Compensation for Termination of IntraLATA Interexchange Traffic

Issue 8E: May Pac-West's rates for termination of intraLATA interexchange traffic exceed Pacific's rates?

Positions

Pacific proposes that compensation for termination of intraLATA interexchange traffic be limited to rates no greater than the rates contained in Pacific's switched access tariff. Pac-West proposes no such limitation.

Discussion

Pac-West's position is adopted. To be clear, this means Section 5.5 shall not include the last sentence proposed by Pacific.

Pacific says it can only charge rates approved by the Commission. According to Pacific, the approval process is extensive, including close scrutiny of the cost basis for the rates. Pacific points out that the approval process for CLEC rates is not subject to extensive review. Pacific is right. This, however, simply describes some of the differences between regulation of ILECs and CLECs.

Pacific's proposal essentially challenges the way the Commission regulates CLECs. There is no reason to modify CLEC regulation here by restricting Pac-West's rate-setting authority relative to other CLECs. Pac-West is correct that it should not be forced to offer service below its self-determined rates, whether those rates are based on cost or any other basis. To do otherwise undermines the competitive structure in the local access market.

Pacific contends the limitations it seeks here are reasonable under the unique circumstances of this proceeding. To the contrary, sufficiently unique circumstances do not exist here to justify a deviation.

4.10 True-Up For Successor Agreement

Issue 8F: Should the Agreement be subject to a true-up based on the successor agreement?

Positions

Pacific proposes, and Pac-West opposes, a true-up provision for the successor agreement.

Discussion

The Agreement shall include a true-up provision. Pacific's clause is adopted.

In a more normal commercial situation, parties simply stop doing business if they fail to agree to essential terms of a successor agreement. In this case, however, parties must continue to provide service beyond the Agreement's term as long as parties are negotiating a successor agreement.

Thus, unless the terms, conditions and rates of the successor agreement are retroactively applied to the period immediately following the term of this agreement, the "term of the agreement" has no real meaning. Rather, either party may feel that the successor agreement is less favorable than the current agreement, and would have an incentive to delay finalizing the successor agreement. The true-up provision neutralizes that incentive.

The Agreement provides that either party may initiate negotiations for a successor agreement nine months before the end of the Agreement (consistent with the nine months under the Act for completion by the Commission of an arbitration). This provides a reasonable opportunity for a successor agreement to be in place prior to, simultaneously with, or very soon after, the expiration of the Agreement. Thus, by terms of the Agreement, the likelihood (and risk) of a true-up should be reasonably minimal, while the benefits of neutralizing disincentives should provide a better opportunity for the parties to finalize a successor agreement.

Pac-West argues that either party may appeal the Commission's arbitration decision to the federal courts. Under these circumstances, Pac-West asserts that uncertainties concerning the successor agreement may continue for months, if not years. Pac-West says such uncertainty is extremely harmful to Pac-West, and, given the disparate sizes of the two firms, disproportionately harmful to Pac-West. Pac-West believes its fundamental dependence on Pacific for a substantial majority of its traffic and revenues makes the imposition of a true-up provision a competitive weapon in Pacific's hands.

To the contrary, this agreement is not intended to be indefinite. Parties should each have the proper incentives to negotiate or arbitrate a successor agreement. A true-up accomplishes that goal. Without a true-up, Pac-West could just as easily as Pacific use the courts for delay and competitive advantage. The "stay the course" approach adopted herein anticipates that the agreement must and will be modified, as necessary, to conform to FCC and Commission decisions that are likely in the reasonably near future. A true-up mechanism is consistent with "stay the course" while bringing the subsequent agreement into alignment with whatever at that time are current FCC and Commission rules and law.

4.11 End Office Trunking

Issue 12: Should the end office trunking language (moved from Section 4.2.1 to Appendix ITR) be changed?

Positions

Pacific says Pac-West relies on older language from Pacific's prior generic agreement. Pacific says the language should be updated, and that its proposed new language more explicitly clarifies the obligations of the parties. Pac-West says Section 1.3 of Appendix ITR should be by mutual agreement, not a requirement, and Section 1.4 should be included to make certain obligations explicit which are not expressly stated elsewhere.

Discussion

Pac-West's proposals are adopted.

Regarding Section 1.3 of Appendix ITR, Pacific did not provide any reason why the use of certain trunk groups should be mandatory under identified conditions. Rather, it is reasonable to require the agreement of both parties before those certain trunk groups are required, since the agreement does not specify the detailed engineering criteria for such determination. Moreover, there is no evidence that either party has failed to establish the optimal and necessary trunks.

Pac-West's proposed Section 1.4 makes clear certain obligations and rights of each party not explicitly stated elsewhere (regarding each party providing sufficient local interconnection trunks on their side of the point of interconnection to handle combined traffic, and to do so at each party's own cost). Pacific raises no compelling argument in opposition.

4.12 Intellectual Property Indemnity

Issue 17: Should intellectual property indemnity be bilateral?

Positions

Pacific contends intellectual property indemnity should not be bilateral. Pac-West argues the indemnity should be bilateral.

Discussion

Pacific's proposed clause is adopted.

Pacific is obligated to provide Pac-West with necessary intellectual property information, thereby enabling Pac-West to interconnect with Pacific. Pac-West is under no similar obligation. Thus, Pacific should not be required to defend and indemnify Pac-West.

Pac-West does not argue that Pacific must not provide Pac-West with necessary intellectual property information. Rather, Pac-West alleges that Pacific is not under an obligation to disclose all potential circumstances where intellectual property, or contract rights of third parties, might limit Pac-West's interconnections with Pacific's network. Even if true, this is not persuasive. Pacific must make reasonable disclosures. Pac-West presents no reasonable, specific evidence of any circumstances that might result in inequity to Pac-West, and its argument is not compelling.

Moreover, Pac-West does not allege that bilateral indemnity is available in any other agreement. Pac-West presents no evidence on the effect of making indemnity bilateral here, let alone throughout the industry. If made bilateral here, most, if not all, CLECs will presumably adopt this change under the broad pick and choose provisions of the Act, as recently interpreted by the Supreme Court.[19] Without some evidence on the effect of such change, it would be unreasonable to adopt that change here.

Pac-West does not dispute that it should indemnify Pacific, only that the obligation be bilateral. Under the circumstances, however, it would be unreasonable to require Pacific to indemnify Pac-West.

4.13 Interconnection Indemnity

Issue 18: Should interconnection indemnity be bilateral?

Positions

[19] AT&T Corp. v. Iowa Utilities Bd., 1999 WL 24568 (U.S.).

Pacific contends interconnection indemnity should not be bilateral. Pac-West argues the indemnity should be bilateral.

Discussion

Pacific's proposed clause is adopted.

Just as discussed above, Pacific has an obligation to provide reasonable information to Pac-West regarding Pacific's network so that Pac-West may interconnect with Pacific. The CLECs have no reciprocal obligation.

Pac-West repeats its assertion that the extreme breadth of the indemnity sought by Pacific goes beyond any disclosures Pacific may be obligated to make. As stated above, however, to the extent reasonable disclosures are required, indemnity is reasonable. Finally, without some evidence of the effect of such change, it would be unreasonable to adopt that change here.

Pac-West does not argue that it should not indemnify Pacific, only that the indemnity should be bilateral. In light of the circumstances, Pacific should not be required to indemnify Pac-West.

4.14 Rights to Modify

Issue 20: What terms should govern the parties' rights to modify the agreement?

Positions

Pacific proposes that provisions of the Agreement affected by subsequent government action be invalidated, modified or stayed "consistent with" the action of the legislative body, court or regulatory agency. Pac-West proposes the affected provision be invalidated, modified or stayed to the extent "explicitly mandated by or required as a matter of law to comply with" the action of the legislative body, court or regulatory agency.

Discussion

Pacific's proposed clause is adopted, as modified herein.

Pac-West's proposal would require affected sections of this agreement to be invalidated, modified, or stayed only "to the extent explicitly mandated by or required as a matter of law to comply with" the subsequent government ruling. This is too restrictive. Rather, the agreement should always be subject to being brought into alignment with appropriate unstayed government rulings.

The treatment of internet traffic, routing and rating issues, and the resulting inter-carrier compensation, are currently subject to considerable attention at legislatures, the FCC and the Commission. Policy in these areas is under review and considerable change is possible. Legislatures, the FCC, and the Commission may give guidance without explicitly requiring amendment to this Agreement. Nonetheless, the Agreement should be subject to that guidance, unless those actions are properly stayed pending appeal. The same should apply to court rulings.

Disputes over consistency with the government rulings, should they arise, will be subject to the dispute resolution provisions of the Agreement. This is a reasonable balance, ensuring that the Agreement remains consistent with current government rulings, while also ensuring that disputes are subject to timely and proper resolution.

Pac-West argues that Pacific's language lets Pacific take unilateral action to interpret a government ruling, and unilaterally cease performance to be "consistent with" Pacific's interpretation of that government ruling. Pac-West says that Pacific has, in Pac-West's view, unilaterally invalidated the existing expired contract.

To the contrary, the proposed clause states that: "...the Parties shall expend diligent efforts to arrive at an agreement respecting the modifications to the Agreement." Nothing cited here shows that either party may cease to perform under the contract, only that both parties must expend diligent efforts to reach an amendment. Failure to agree on an amendment will allow either party to invoke the dispute resolution process provided in the Agreement.

The existing alleged nonperformance is the subject of one or more complaint proceedings. Whether alleged nonperformance was, or is, permissible or tolerable will be resolved there. Nothing presented here, however, convinces me that the possibility of nonperformance justifies Pac-West's restrictive proposal.

Moreover, using Pac-West's proposed language, it might be argued that the government ruling must explicitly require this specific Agreement to be modified. While Pac-West does not argue that here, Pac-West or Pacific (depending upon whom is advantaged or disadvantaged) might assert that in a subsequent dispute. An arbitrator, under the dispute resolution provisions of the Agreement, might agree. In my view, that would be inconsistent with the "stay the course" approach of this arbitration, which largely seeks to maintain current treatment regarding the threshold issues, but leaves the Agreement subject to timely modification when the FCC or this Commission first resolve the issues of internet calls, routing and rating, and inter-carrier compensation (unless those decisions are stayed). The restrictive provision for modification proposed by Pac-West would frustrate that objective, and is thereby unreasonable.

Pac-West asserts that FCC and Commission decisions are subject to rehearing and lengthy appeals. As such, Pac-West says the agreement should not be modified again and again until the question is finally decided. Rather, Pac-West argues that the Agreement should only be amended when a final decision is reached.

To the contrary, when each government ruling is effective it must be implemented, unless stayed. Pac-West is right that some instability may result if parties must modify arrangements as government rulings change. If this is a valid concern in specific situations, parties may move for stay of a specific order using that argument. In valid situations, that motion may be granted. As a general policy, however, it is unreasonable to require parties to wait until resolution of the last possible appeal or reconsideration by the legislature, regulatory agencies, or the courts before implementing valid government rulings as decisions are made.

Pac-West argues that modifications to reflect government rulings are possible at any time when mutually agreeable. Under these circumstances, according to Pac-West, mutual agreement would be required, thereby removing changed regulation as a strong-arm tactic or basis for unilateral abrogation of the agreement.

While it is true that mutually agreeable amendments are possible at any time, I believe the agreement should be subject to amendment when a government ruling is issued and the ruling is not stayed. Otherwise, the party that is disadvantaged by the ruling will always disagree with an amendment, and the goal of timely implementation of unstayed orders will be frustrated.

The right to modify clause, however, should be changed from that proposed by the parties in one respect. As proposed by Pacific and Pac-West, the language says:

> "If the actions of the State of California or federal legislative bodies, courts, or regulatory agencies of competent jurisdiction, to include the United States Supreme Court's decision in AT&T Corp. v. Iowa Utilities Bd., 1999 WL 24568 (U.S.), and any remand thereof, invalidate, modify or stay the enforcement of laws or regulations that were the basis for a provision of this Agreement..."

I believe this can reasonably be read to limit changes to those related to, or caused by, the cited Supreme Court decision. Both parties' briefs are clear, however, that this clause is intended to cover any actions of California or federal legislatures, courts, or regulatory agencies. Moreover, Commission policy requires that interconnection agreements are always subject to modification based on subsequent Commission orders. The agreement must clearly reflect that. As such, the clause should be modified to read (with deletions in brackets and the change identified here in capital letters, only for ease of seeing the change):

> "If the actions of the State of California or federal legislative bodies, courts, or regulatory agencies of competent jurisdiction, [to include] INCLUDING BUT NOT LIMITED TO the United States Supreme Court's decision in AT&T Corp. v. Iowa Utilities Bd., 1999 WL 24568 (U.S.), and any remand thereof, invalidate, modify or stay the enforcement of laws or regulations that were the basis for a provision of this Agreement..."

4.15 Performance Measures

Issue 22: What performance measures should be adopted?

Positions

Pac-West says Pacific's proposed Performance Measures appendix is currently under review by the Commission as a generic matter, and that the specifically proposed appendix here will be replaced by the ultimate result of that Commission process. Pac-West says it agrees with the currently proposed appendix being interim, but supports two modifications. Pacific does not take a position on Pac-West's proposed modifications.

Discussion

Pac-West's proposals are adopted. Pacific presents no argument in opposition. As such, it is reasonable for Section 1.0 to be subject to the Commission's decision, not Pacific's subsequent approval thereof. Further, Section 2.0 (Reservation of Rights) should be deleted. As Pac-West says, the Commission's determination should establish Pacific's obligations without the reservations sought by Pacific. The reservation of rights sought by Pacific diminishes the meaningfulness of any performance measures, and reduces the economic consequence to Pacific of failing to meet such measures.

Further, Pacific first provided its proposed Performance Measures appendix on March 2, 1999. This was well into the arbitration hearing process. Pacific failed to raise these significant proposals at a stage early enough to permit Pac-West meaningful evaluation and response. As such, Section 2.0 is deleted.

In comments on the DAR, Pacific says the issues of if, how and when performance measures should be incorporated into existing interconnection agreements are now pending in a generic proceeding. Pacific says it is best to avoid deciding in this arbitration an issue which should be left to the generic proceeding. To the contrary, issues presented in this proceeding's Statement of Unresolved Issues must be arbitrated. To the extent the generic proceeding subsequently produces a different outcome, parties may seek to modify the Agreement consistent with the provisions for contract modification. (Issue 20, Section 4.14 above.)

ORDER

IT IS ORDERED that, within seven days of today, the parties shall file and serve:

1. An entire Interconnection Agreement, for Commission approval, that conforms with the decisions in this Final Arbitrator's Report.
2. A statement which (a) identifies the criteria in the Act and the Commission's Rules (e.g., Rule 4.3.1, Rule 2.18, and 4.2.3 of Resolution ALJ 174) by which the negotiated and arbitrated portions of the Agreement must be tested, (b) states whether the negotiated and arbitrated portions pass or fail those tests, and (c) states whether or not the Agreement should be approved or rejected by the Commission.

Dated April 23, 1999, at San Francisco, California.

Burton W. Mattson
Arbitrator